No. 22217

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HOLLYWOOD NATIONAL BANK,

Appellant,

vs.

A. J. BUMB,

Appellee.

APPELLANT'S OPENING BRIEF.

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APPELLANT'S OPENING BRIEF.

Jurisdictional Statement.

This is an appeal from an order entered on March 23, 1967, by the United States District Court for the Central District of California, denying appellant's petition to review and reverse an order of the Referee in Bankruptcy in Chapter XII proceedings. Appellant (also called "the bank" herein) became involved in the Chapter XII proceedings when, upon the filing of an application by appellee (also called "the trustee" herein), the referee ordered appellant to appear and show cause why the referee should not find and order that appellant had damaged the estate [Application, R. 1-43; Order to Show Cause, R. 44-45]. Thereupon, appellant appeared specially, challenged the referee's jurisdiction to adjudicate the issue raised in the application, and

moved for a dismissal of the application and the order to show cause [R. 91-94].

When the referee denied appellant's motion [R. 46-47], it filed a petition for review [R. 48-49] pursuant to Section 39c of the Bankruptcy Act, 60 Stat. 326 (1946), as amended, 11 U.S.C. §67(c). The District Court's jurisdiction to consider the petition for review and the motion for dismissal rested upon said statute as well as upon Section 2a(10) of the Bankruptcy Act, 30 Stat. 545 (1898), as amended, 11 U.S.C. §11(a) (10). When the District Court denied the petition and motion [R. 76-77], appellant filed a notice of appeal [R. 79] in the time required by Section 95 of the Bankruptcy Act, 30 Stat. 553 (1898), as amended, 11 U.S.C. §48.

This Court's jurisdiction rests upon Section 416 of the Bankruptcy Act, 52 Stat. 918 (1938), 11 U.S.C. §816, and Section 24 of the Bankruptcy Act, 30 Stat. 553 (1898), as amended, 11 U.S.C. §47.

Statement of the Case.

In December of 1965, appellant, Hollywood National Bank, acted as escrow holder for the sale of a piece of real property consisting of land and apartment houses thereon, known as Sycamore Manor; in January of 1966, the bank acted as escrow holder for the sale of similar real property known as Mountain View Manor. In each escrow, the seller was appellee, as the duly appointed trustee for the estate of the debtor in Chapter XII proceedings, and the buyer was one San Ysidro

Ranch Corporation. The trustee sold Sycamore Manor and Mountain View Manor pursuant to the referee's orders authorizing their sale [R. 9-12, 17-19; R. 27-30, 35-37]. The orders did not make mandatory, but permitted, the opening of escrows to consummate the sales.

The buyer approved by the referee and the trustee saw fit to contract with the bank to handle escrows for the sales. The bank had no connection with the sales other than as the escrow agent of the seller and of the buyer. The bank did not at any time own any part of the properties that were conveyed by means of the escrows, nor did the bank ever have any other right, title or interest in or to any part of the properties.

The bank has not participated in any way in the Chapter XII proceedings. This appeal is necessary because the referee is attempting to assert summary jurisdiction over the bank in such proceedings for the purpose of adjudicating whether the estate was damaged by the bank in closing the escrows.

In an application to the referee [R. 1-43], the trustee alleged that the bank violated the escrow instructions and thus damaged the estate in the total sum of $81,610.22 ($51,917.40 in connection with the Sycamore Manor escrow and $29,692.82 in connection with the Mountain View Manor escrow). Based on this application, the referee ordered the bank to show cause why it should not be held liable for said sums [R. 44-45].

The bank moved to dismiss the trustee's application and the order to show cause on the ground that the referee "has no jurisdiction over the subject of said application . . ., and lacks the power to issue the orders contemplated by said Order to Show Cause" [R. 91-94; lines 24-27 of R. 91]. The referee denied the motion to dismiss [R. 46-47]; when the District Court denied appellant's petition for review and dismissal [R. 76-77], this appeal followed [R. 79].

Although the bank denies that it closed the escrows in violation of the escrow instructions and denies that the estate has been damaged by the closings [Answer, R. 50-56; Counter-Claim and Cross-Complaint, R. 57-62], these issues are not involved in this appeal. The referee has not yet adjudicated such issues, and whether he has summary jurisdiction to do so is the sole issue involved in this appeal.

Statutes Involved.

I.

Section 2 of the Bankruptcy Act, as amended (11 U.S.C. §11), provides, in pertinent part, as follows:

> "a. The courts of the United States herein before defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation,

in chambers, and during their respective terms, as they are now or may be hereafter held, to—

. . .

(6) Bring in and substitute additional persons or parties in proceedings under this Act when necessary for the complete determination of a matter in controversy;

(7) Cause the estates of bankrupts to be collected, reduced to money, and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate whenever, under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest; and where in a controversy arising in a proceeding under this Act an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy, by answer or motion filed before the expiration of the time prescribed by law or rule of court or fixed or extended by order of court for the filing of an answer to the petition, motion or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction;

. . .

(15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act:

provided, however, That an injunction to restrain a court may be issued by the judge only;

. . .

b. Nothing in this section contained shall be construed to deprive a court of bankruptcy of any power it would possess were certain specific powers not herein enumerated."

II.

Section 23 of the Bankruptcy Act, as amended (11 U.S.C. §46), provides as follows:

"a. The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under this Act, between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed by the receivers or trustees, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.

b. Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, unless by consent of the defendant, except as provided in sections 60, 67, and 70 of this Act."

Specification of Errors Relied On.

I.

The Referee erred in denying the motion for dismissal.

II.

The District Court erred in denying the petition for review and dismissal.

III.

The Referee and District Court erred in holding that the Referee in Bankruptcy has jurisdiction to make the determinations and issue the orders contemplated by the Application for Order to Show Cause for Damages for Wrongful Close of Escrow.

Summary of Argument.

I.

Courts of bankruptcy do not have summary jurisdiction over controversies not strictly or properly part of the proceedings in bankruptcy.

II.

The summary jurisdiction of bankruptcy courts is limited to the jurisdiction conferred upon them by the Bankruptcy Act even though the bankruptcy courts apply principles of equity.

III.

A court of bankruptcy does not have summary jurisdiction over a trustee's suit for breach of contract.

ARGUMENT.

I.

Courts of Bankruptcy Do Not Have Summary Jurisdiction Over Controversies Not Strictly or Properly Part of the Proceedings in Bankruptcy.

The Bankruptcy Act provides no authority to a court of bankruptcy to make summary disposition of the trustee's claim against the bank, and "[t]he bankruptcy court has no broader power than that conferred upon it by statute." *Lowenstein v. Reikes* (2nd Cir. 1931), 54 F. 2d 481, 483, *cert. denied,* 285 U.S. 539, 52 S. Ct. 311, 76 L. Ed. 932.

"The summary jurisdiction of (the bankruptcy) Court has been confined to matters in rem and by its very nature is based upon the actual or constructive possession of the res in the debtor or his agent at the time of the filing of the petition in bankruptcy." *In re Spur Fuel Oil Sales Corp.* (E.D.N.Y. 1962), 204 F. Supp. 696, 698. Thus, summary proceedings are appropriate only when the court is handling "matters relating to the administration of the bankrupt's estate and the property in the court's possession" (2 *Collier on Bankruptcy* 438 [14th ed.]).

Section 2 of the Bankruptcy Act (11 U.S.C. § 11) lists various powers of the bankruptcy courts; these powers can be exercised summarily and include the adjudication of controversies strictly and properly part of the administration of the bankrupt's estate and proper-

ty in the court's possession. However, in *Bardes v. First National Bank of Hawarden* (1900), 178 U.S. 524, 535, 20 S. Ct. 1000, 1005, 44 L. Ed. 1175, 1181, the Supreme Court emphasized the limitations upon the summary jurisdiction created by Section 2, as follows:

> "The section nowhere mentions civil actions at law, or plenary suits in equity. And no intention to vest the courts of bankruptcy with jurisdiction to entertain such actions and suits can reasonably be inferred from the grant of the incidental powers, in clause 6, to bring in and substitute additional parties 'in proceedings in bankruptcy', and, in clause 15, to make orders, issue process and enter judgments, 'necessary for the enforcement of the provisions of this Act.'
>
> "The chief reliance of the appellant is upon clause 7. But this clause, in so far as it speaks of the collection, conversion into money and distribution of the bankrupt's estate, is no broader than the corresponding provisions of section 1 of the act of 1867; and in that respect, as well as in respect to the further provision authorizing the court of bankruptcy to 'determine controversies in relation thereto,' it is controlled and limited by the concluding words of the clause, 'except as herein otherwise provided.' "

The Supreme Court then pointed out that the words "herein otherwise provided" refer to Section 23 of the Bankruptcy Act. *Ibid.* Pointing out that the second clause of Section 23 covers "controversies, not strictly or properly a part of the proceedings in bank-

ruptcy, but independent suits brought by the trustee in bankruptcy to assert a title to money or property as assets of the bankrupt against strangers to those proceedings," (*Id.* at 178 U.S. 537-538), the Court concluded as follows:

> "The provisions of the second clause of section 23 of the Bankruptcy Act of 1898 control and limit the jurisdiction of all courts, including the several District Courts of the United States, over suits brought by trustees in bankruptcy to recover or collect debts due from third parties. . . ." (*Id.* at 178 U.S. 539.)

Thus, whether the trustee in the present case is asserting title to money as an asset of the estate or is attempting to collect a debt, Section 23 prevents the referee from assuming summary jurisdiction. A bankruptcy court obviously cannot adjudicate such controversies in that Section 23 provides that they must be brought "in the same manner" and "in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted. . . ." (There is no issue in the present case involving consent, or proceedings under Sections 60, 67, or 70 of the Bankruptcy Act.)

In the case of *In re Houston Seed Co.* (N.D. Ala. 1954), 122 F. Supp. 340, the trustee moved for disallowance of certain creditors' claims and filed counterclaims against them for a money judgment in the bankruptcy court; the counterclaims sought recovery for moneys loaned by the bankrupt, for negligent mismanagement of the bankrupt's affairs, for fraudulent misappropriations, for deceit, and for breach of fiduciary duties as officers and directors of the bankrupt. In spite of the fact that a claim had been filed and

the fact that the parties being sued by the trustee had owed fiduciary obligations to the bankrupt, the court ruled that the bankrupt court did not have jurisdiction to adjudicate the trustee's causes of action for sums beyond the amounts set out in the proofs of claims.

Even if a bankruptcy court attempts to proceed in a formal, plenary manner in adjudicating such causes of action, it can not do so because of lack of jurisdiction. The *Houston* court pointed out that such suits "fall within Section 23" and "under Section 23 jurisdiction of plenary suits encompassing 'controversies at law and in equity, as distinguished from proceedings under this title' is withdrawn from courts of bankruptcy." *Id.* at 342.

II.

The Summary Jurisdiction of Bankruptcy Courts Is Limited to the Jurisdiction Conferred Upon Them by the Bankruptcy Act Even Though the Bankruptcy Courts Apply Principles of Equity.

It is apparently appellee's position that the referee has jurisdiction in the present case because bankruptcy courts have "equity jurisdiction."

Even if the trustee's application stated an equitable cause of action and prayed for equitable relief (instead of praying for damages resulting from breach of contract), the fact remains that the referee's "equity jurisdiction" is coterminous with the jurisdiction conferred by the Bankruptcy Act. The court stated in *Burton Coal Co. v. Franklin Coal Co.* (8th Cir. 1933), 67 F. 2d 796, 797:

> "Some question is raised as to the equity jurisdiction of the bankruptcy court. That it is a court of equity in the sense that 'its judges and

referees, in adjudging the rights of parties entitled to their decision, are governed by the principles and rules of equity jurisprudence,' is beyond question. (Citations) It has not, however, plenary jurisdiction in equity, but is confined, in the application of the rules and principles of equity, to the jurisdiction conferred upon it by the provisions of the Bankruptcy Act, reasonably interpreted. (Citation)

"The plain mandate of the law cannot be set aside because of considerations which may appeal to referee or judge as falling within general principles of equity jurisprudence."

III.

A Court of Bankruptcy Does Not Have Summary Jurisdiction Over a Trustee's Suit for Breach of Contract.

The application filed by the trustee [R. 1-43] apparently attempts to state one cause of action, that being for breach of contract; and the sole relief prayed for is an order fixing monetary damages. The application alleges that the trustee "entered into an escrow agreement" with the bank [R. 2, lines 5-6, and R. 4, lines 24-25], that the bank closed the escrow "in violation of the written escrow instructions" [R. 2, lines 29-30, and R. 5, lines 17-18], that the escrow was closed "in direct violation of the escrow instructions" [R. 3, lines 7-8, and R. 5, lines 27-28], and that the trustee and the "estate will, therefore, be damaged by the closing of the escrow by HOLLYWOOD NATIONAL BANK in violation of the terms of the escrow instructions" [R. 4, lines 2-4, and R. 6, lines 22-24]. The

application prays for an adjudication of damages caused "by the closing of the escrow . . . in the fashion alleged herein" [R. 6, lines 31-32, and R. 7, lines 3-4]. Although there is some doubt as to whether the application adequately states a cause of action for breach of contract, at least it tries to do so. It does not attempt to state a cause of action for anything else, either in law or in equity.

The contract on which the trustee is suing, the escrow instructions, was entered into by the trustee himself after his appointment as trustee. This aspect of the case is similar to that in *Morrison v. Bay Parkway Nat. Bank* (2nd Cir. 1932), 60 F. 2d 41, *petition for cert. dismissed,* 296 U.S. 669, 57 S. Ct. 756, 89 L. Ed. 2008, in which the trustee filed petition against a bank on a contract which was made after the trustee's appointment and which involved funds of the estate. The district court ruled that summary proceedings on the trustee's petition were proper, but the Circuit Court of Appeals reversed and ordered the petition to be dismissed, holding that "a trustee cannot enforce claims for a breach of contract in a summary proceeding, but must resort to a plenary suit." *Id.* at 42.

Another relevant case involving a dispute between a bank and a trustee in bankruptcy is *In re Eiken* (2nd Cir. 1946), 154 F. 2d 717; in this case, the bank permitted the bankrupt to disburse funds out of an account after the bank knew of the bankruptcy proceeding. The trustee petitioned the referee for an order directing the bank to pay over the deposit and, at the hearing on the order to show cause, the bank challenged the summary jurisdiction of the bankruptcy court. The referee, the district court, and the Cir-

cuit Court of Appeals all agreed that "the claim of the Trustee could only be enforced in a plenary suit." *Id.* at 719. The appellate court stated as follows:

> "[A]n action to enforce a debt from the alleged debtor of the bankrupt, where the debtor denies the existence of the debt, is not within the summary jurisdiction. The Trustee, in such a case, cannot claim possession, because the existence of the chose in action is the issue in dispute." *Ibid.*

As the *Spur Fuel Oil* case points out, bankruptcy proceedings are "confined to matters in rem." *In re Spur Fuel Oil Sales Corp., supra.* It is therefore basic that an action in personam, such as one for monetary damages for breach of contract, cannot be summarily disposed of in the bankruptcy proceedings. When this basic point is ignored, a party's rights—as well as the integrity of the system—are violated.

Appellant therefore urges the application of the following concepts to the present case:

> "The exclusive jurisdiction of the bankruptcy court is limited to proceedings in bankruptcy as distinguished from ordinary suits at law or in equity. . . . Actions for merely money judgments or for other relief in personam, where the court does not attempt to recover any property transferred by the bankrupt, or its value, but merely renders judgment in personam for a debt or other obligation not arising from a transfer by the bankrupt, or orders specific performance of some contract or duty, may be instituted against a debtor, or other third party, only in the court in which the bankrupt himself, or his creditors, had there

> been no bankruptcy, might have instituted them, and may not, except by consent, be instituted in the bankruptcy court." 9 Am. Jur., *Bankruptcy* §1157 (2nd ed.).

In summary, this Court's recent language in another case involving appellee as trustee in connection with summary proceedings, is very appropriate in the present case:

> "The power of a bankruptcy court to resolve adverse claims concerning the assets of the bankrupt's estate is indeed a power of imposing magnitude. Since it results in depriving adverse claimants of a plenary suit, we must ever be cautious lest we permit its extension to a situation that should not permit summary disposition. . . . When . . . the property in question is in the possession of third parties who purport to hold the property free of any claim of the bankrupt, we must carefully examine whether the expedited summary process is appropriate to the situation, This would seem particularly true in a situation, such as the present, where the property in question is a money claim against third parties rather than a physicial asset alleged to be part of the bankrupt's estate." *Suhl v. Bumb* (9th Cir. 1965), 348 F. 2d 869, 871-872, *cert denied,* 382 U.S. 938, 86 S. Ct. 388, 15 L. Ed. 2d 349.

This Court held in *Suhl v. Bumb, supra,* that appellee had to bring a plenary proceeding to avoid "abrogation of an individual's right" (*Id.* at 874). It is submitted that this is equally true in the present case.

Conclusion.

For the reasons stated, it is respectfully submitted that the referee's order denying the motion for dismissal, and the district court's order denying the petition for review and dismissal, should be reversed, and that the cause should be remanded with instructions to enter an order dismissing the Application for Order to Show Cause for Damages for Wrongful Closing of Escrow.

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

MILTON COPELAND